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NEWCASTLE

Newcastle Market-Neutral Trust
December 31, 2001
Annual Report

NORTHWATER

Renamed Northwater
Market-Neutral Trust
effective February 1, 2002





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Message to Unitholders from the Advisor

The Newcastle Market-Neutral Trust (the "Trust") is a closed-end fund comprising a diversified portfolio of market-neutral hedge funds that is traded on The Toronto Stock Exchange. As of December 31, 2001, the net asset value of the Trust per unit was \$18.59. For the fourth quarter, the net asset value of the Trust per unit declined by 1.54%. For the year, the net asset value per unit increased 10.58%, after taking into account distributions per unit of \$2.17.

The past year has been one of extreme market events. Examples of shocks sustained by the capital markets this past year include: the events of September 11th, the Enron bankruptcy, the Argentinian financial crisis, the California energy crisis, and the US government's surprise decision to cease issuing the benchmark 30-year bond. In addition to double-digit percentage declines in both US and Canadian equity markets, global central banks continued to cut interest rates aggressively. The US Federal Reserve lowered interest rates on 11 different occasions in 2001 by a total of 4.75%. Northwater was particularly pleased with the portfolio's resilience in the face of these market shocks and believes it highlights the advantages of market-neutral investing.

The number of corporations filing for bankruptcy also continued to rise in 2001. Recent high-profile companies such as Enron, K-Mart, Global Crossing and McLeod USA represent some of the largest bankruptcy filings in history. The abundance of distressed corporations across a wide variety of industries has led to tremendous opportunities for managers in the distressed security arena. By contrast, the current economic downturn has dramatically lowered the number of mergers and acquisitions, as companies are both focused on cost cutting and reluctant to use their "cheap" equity as currency in acquisitions.

Northwater continued to change the fund's portfolio in order to capitalize on the shifting financial climate. Over the course of the year, 16 new funds were added to the portfolio with the objective of generating consistent results regardless of the overall market environment. The focus continues to be building as diversified and resilient a portfolio as practicable.

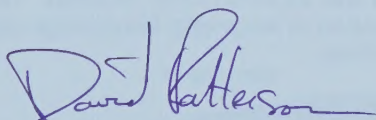
In 2001, Northwater increased the portfolio weight of distressed securities and market-neutral equity. The market environment for distressed securities has improved substantially over the past 18 months as corporate bond defaults set new records monthly. Northwater has identified several unique managers whose investments in this area are non-traditional. Specifically, Northwater's managers invest primarily in the senior, secured bank debt of financially distressed companies where the probability of substantial cash recovery is high.

Northwater has also increased the weight of market-neutral equity in the portfolio by allocating funds to managers exploiting inefficiencies in global options markets. Realizing the lack of price discovery in non-US markets, these managers are able to buy and sell mispriced options while offsetting their market exposure through trades in the underlying securities.

Merger arbitrage enjoyed strong gains throughout the bull market of the 1990's as companies used their rising equity prices in acquiring their competitors and service providers. With the substantial, and sustained decline in equity markets, companies have become reluctant to use their "undervalued" stock in acquisitions. In addition to the existence of fewer deals and tighter spreads, 2001 saw a number of high-profile deals break. Most notably, the European Commission blocked General Electric's purchase of Honeywell despite US regulatory approval for the deal. As a consequence of the declining number of quality opportunities in merger arbitrage, Northwater has continued to lower its exposure to this area. The move to a lower weight for merger arbitrage was appropriate, as the strategy was the Trust's weakest performer in 2001.

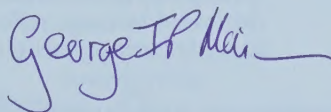
Northwater continues to focus on improving the portfolio by refining its stable of managers and focusing on market-neutral strategies that, despite a difficult economic environment, are able to deliver strong, risk-adjusted returns. Northwater replaces existing managers with others who are either better hedged or who are perceived to be better able to add value through their unique investment approaches.

Northwater remains committed to market-neutral investing as an essential element of any truly diversified portfolio. The Trust's well-constructed portfolio of market-neutral hedge funds offers among the best risk-adjusted returns available in the market today:



DAVID G. PATTERSON

Chair and Chief
Executive Officer



GEORGE I. MAIN, CFA

Managing Director

February 19, 2002

MANAGEMENT DISCUSSION AND ANALYSIS

Investment Objectives

The Trust's investment objectives are:

1. Distribute \$0.40 per unit per quarter (\$1.60 per annum);
2. Steadily grow the net asset value;
3. Ensure that the performance of the Trust is substantially independent of fixed income and equity markets; and
4. Achieve low volatility, which is expected to be less than that of a mid-term bond portfolio and less than one-half that of major North American stock markets.

Investment Strategy

The Trust comprises market-neutral hedge funds that have excellent expected returns as well as performance histories that have a low correlation with major equity and debt markets. In establishing the hedge fund "mix," the Advisor selects strategies that also have a low correlation with one another, thereby increasing diversification and reducing expected volatility.

The Trust employs leverage to enhance investment returns. The Trust is entitled to borrow up to 25% of the net asset value for investment purposes, and an additional 10% of the net asset value for effecting the purchase and buy-back program, maintaining liquidity to effect cash distributions and settling currency hedging transactions. The financial leverage as at December 31, 2001 was 25.58% (2000: 26.55%). The decreased leverage reflects a reduction of temporary borrowings made to settle currency hedging transactions.

Investment Activity

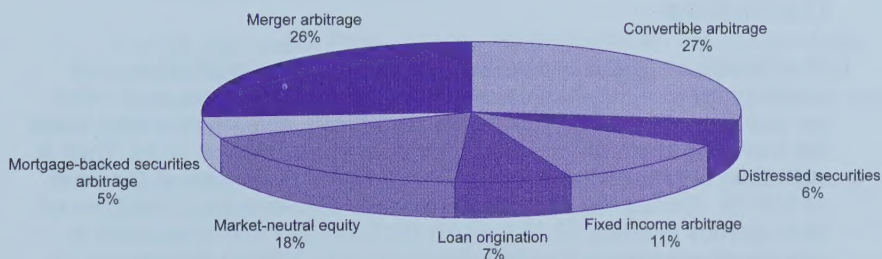
During the year, as part of its regular investing activities and with a view to enhancing diversification and providing risk reduction to the overall portfolio, the Trust placed investments with 16 new hedge fund managers (2000: 16 hedge fund managers) and redeemed investments from ten other hedge fund managers (2000: six hedge fund managers).

As at December 31, 2001, the Trust was invested in 44 hedge funds (2000: 38 hedge funds) with 35 managers (2000: 33 managers) engaged in seven unique market-neutral or hedged investment strategies. This wide array of hedge fund investments has created broad diversification through which the Trust seeks to achieve its risk/return objectives and market neutrality.

Asset Allocation by Investment Strategy

Hedge Fund Investments

| Strategy | As at December 31, 2001 | | | | As at December 31, 2000 | | |
|---|--------------------------|----------------|------|--|--------------------------|---------------|------|
| | No. of Hedge Funds | Fair Value | | | No. of Hedge Funds | Fair Value | |
| Convertible arbitrage | 11 | \$ 33,646,124 | 27% | | 10 | \$ 34,465,395 | 28% |
| Distressed securities | 4 | 8,068,872 | 6% | | 2 | 5,036,654 | 4% |
| Fixed income arbitrage | 5 | 13,155,070 | 11% | | 4 | 10,299,280 | 8% |
| Loan origination | 3 | 8,941,899 | 7% | | 3 | 10,452,290 | 9% |
| Market-neutral equity | 8 | 22,662,624 | 18% | | 5 | 20,107,002 | 16% |
| Mortgage-backed securities arbitrage | 2 | 6,505,284 | 5% | | 2 | 7,657,590 | 6% |
| Merger arbitrage | 11 | 31,934,015 | 26% | | 12 | 36,055,565 | 29% |
| | 44 | 124,913,888 | 100% | | 38 | 124,073,776 | 100% |
| Settlement due on currency futures | | (81,939) | | | | 115,620 | |
| | | \$ 124,831,949 | | | | \$124,189,396 | |



Review of Financial Results

Performance

During 2001, the performance of the Trust continued the strong trend established in 2000, posting a return of 10.58% (2000: 15.12%) for the year, taking into account distributions made during the year. All seven of the Trust's strategies contributed significantly to the overall return. In particular, mortgage-backed securities, market-neutral equity and loan origination strategies were key to the success of the Trust in 2001. The strong performance of the Trust, despite the declines experienced in the equity and bond markets, reflects the market-neutral nature of the Trust's hedge fund portfolio.

With the continued trading discounts prevalent in the market, the Trust was again able to capitalize on the share buy-back and cancellation program during the year to provide additional returns to the unitholders. Over the year, this program contributed 0.46% (2000: 2.29%) to returns.

Net Asset Value and Price Per Unit

The Trust's net asset value per unit is calculated and reported monthly. For the year ended December 31, 2001, the net asset value per unit of the Trust fluctuated between a low of \$18.55 and a high of \$19.71 (2000: low of \$18.81 and high of \$19.76 per unit), after taking into account distributions. The relatively narrow band around the net asset values in 2001 reflects the payment of distributions out of the growth of the Trust throughout the year.

As in prior years, the Trust traded at a discount. The trading price of the units fluctuated between \$15.85 and \$18.75 (2000: \$14.00 and \$16.05) during the year.

Distributions

The Trust is obligated to distribute \$0.40 per unit to unitholders on a quarterly basis. Distributions are determined using the net asset value per unit for the month prior to each quarter end, and are permitted under the trust agreement as long as the net asset value per unit of the Trust at such time is greater than the initial net asset value per unit of the Trust of \$18.79. During the year, the Trust made distributions in the three of four quarters totalling \$2.17 per unit (\$12,475,419 was distributed in aggregate) as compared to four distributions in 2000 in the amount of \$2.89 per unit (\$17,757,559 in aggregate). The distributions of \$2.17 per unit (2000: \$2.89 per unit) included payments of \$0.97 per unit (2000: \$1.29 per unit) towards distributions that were in arrears. As at year end, distributions in arrears amounted to \$0.48 per unit and \$2,731,036 in aggregate (2000: \$1.05 per unit; \$6,204,617 in aggregate). The remaining distributions in arrears will be paid to investors, on a

quarterly basis, as they are earned. Northwater's interests remain aligned with those of the investor: as long as there are any distributions owing to the investors, Northwater's management fee is not paid nor reflected in the net asset value of the Trust. Once all distributions in arrears have been paid, management fees will only be accrued and paid if such an accrual and payment will not prohibit the payment of current distributions to unitholders. As at December 31, 2001 the management fees in arrears that had not been accrued were \$7,051,825 (2000: \$5,685,322).

Distribution History

| Record date | Date distribution paid | Character of distribution for tax purposes | Amount per unit |
|--------------------|------------------------|--|-----------------|
| March 31, 1998 | April 22, 1998 | Return of capital | \$0.32 |
| June 30, 1998 | July 21, 1998 | Return of capital | \$0.37 |
| December 31, 1999 | January 31, 2000 | Return of capital | \$0.57 |
| March 31, 2000 | April 14, 2000 | Return of capital | \$0.97 |
| June 30, 2000 | July 14, 2000 | Return of capital | \$0.88 |
| September 29, 2000 | October 13, 2000 | Return of capital | \$0.73 |
| December 29, 2000 | January 12, 2001 | Return of capital | \$0.31 |
| March 30, 2001 | April 17, 2001 | Return of capital | \$0.92 |
| June 29, 2001 | July 17, 2001 | Return of capital | \$0.84 |
| September 28, 2001 | October 19, 2001 | Return of capital | \$0.41 |

Net Income from Operations

For the year ended December 31, 2001, the Trust's net income from operations was \$10,841,484 (2000: \$14,955,071). As in 2000, and consistent with the Trust's objectives, the key contributing factors were the realized and unrealized gains on hedge fund investments.

The impact of expenses for the years ended December 31, 2001 and 2000 is analyzed in the following table:

| Ratio of expenses to weighted-average net assets | 2001 | 2000 |
|--|-------|-------|
| Excluding loan interest and stand-by fees | 0.19% | 0.19% |
| Including loan interest and stand-by fees | 1.50% | 2.03% |
| If management fees were payable in the year | 2.75% | 3.28% |

Currency Hedging

The Trust uses derivative contracts to hedge the currency exposure of investments denominated in U.S. dollars. A portion of the Trust's liabilities, which are denominated in U.S. dollars, provides a natural hedge to the U.S. dollar denominated assets.

The following table summarizes the impact of currency exchange for the years ended December 31, 2001 and 2000 after taking into account the hedging activities of the Trust.

| | 2001 | 2000 |
|--|-------------------|------------------|
| Currency exchange on hedge fund investments denominated in U.S. dollars: | | |
| Net realized gain | \$ 1,984,261 | 5,592,867 |
| Change in unrealized appreciation (depreciation) | 5,700,516 | (477,630) |
| Currency hedging of U.S. dollar denominated investments | (6,555,735) | (5,096,905) |
| Translation gain (loss) on natural hedge | (974,182) | (787,699) |
| Net impact of currency exchange | \$ 154,860 | (769,367) |

Purchases for Cancellation

Under its trust agreement, the Trust is required to make purchases of units of up to 2% of the outstanding units per quarter if the price at which the units trade in the market is less than 92.5% of the net asset value per unit as at the close of business on the preceding valuation date. In addition, the Trust may purchase units whenever they are offered for sale at less than their net asset value.

In December 2001, the Trust filed a notice of intention to make normal-course purchases of its units with The Toronto Stock Exchange. In its filing with the exchange, the Trust indicated an intention to purchase up to 563,436 of the units of the Trust, representing 10% of the public float of the Trust then outstanding. In accordance with exchange rules and by-laws, the Trust may not pay more than the most recent market price for the units purchased. Units purchased under the bid are cancelled.

During the year ended December 31, 2001, the Trust purchased 219,500 units (2000: 518,600 units) for cancellation under these programs for a total amount of \$3,732,907 (2000: \$7,982,175). Given that the net asset value of the units cancelled amounted to \$4,241,738 (2000: \$10,016,104), this resulted in a gain of \$508,831 (2000: \$2,033,929) for the Trust. This gain reflects a 0.46% (2000: 2.29%) addition to the overall return.

Distribution Reinvestment Plan

The Trust offers investors the opportunity to enroll in a Distribution Reinvestment Plan (the "Plan"). The Plan allows investors to conveniently acquire additional units of the Trust by reinvesting their cash distributions. Purchases are made in the market if units of the Trust are trading at a price that is less than their net asset value. If units of the Trust are trading at a price that is greater than their net asset value, new units will be issued at a price that is the greater of their net asset value and 95% of the weighted average of the trading prices of the units over the five-day period prior to the declaration of the distribution. Purchases made under this plan in 2001 amounted to 23,916 units (2000: 46,718 units).

The Plan is a way to participate in the growth of the Trust. There is no charge to the participant for enrollment in the Plan.

If you are a registered unitholder and are interested in enrolling in the Plan, please complete an enrollment form and send it to the Plan Agent: CIBC Mellon Trust, P.O. Box 7010, Adelaide Street Postal Station, Toronto, Ontario M5C 2W9, or call 1-800-387-0825. Enrollment forms are available from your broker.

If you are the owner of units in an account with a broker or financial institution, you may provide them with a direction to enroll your units in the Plan.

Name Changes

During the year, the Trust's manager changed its name from Newcastle Fund Management Inc. to Northwater Fund Management Inc.

The Trust's advisor, Northwater Capital Management Inc., was formed during the year on the amalgamation of Newcastle Capital Management Inc. and NewQuant Capital Inc.

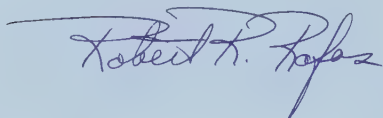
Effective February 1, 2002, the Trust changed its name to Northwater Market-Neutral Trust.

Management's Responsibility

The accompanying financial statements have been prepared by Northwater Fund Management Inc., the Manager of the Trust ("Manager"), and approved by the Board of Directors of the Manager. The Manager is responsible for the information and representations contained in these financial statements and other sections of the Annual Report.

The Manager maintains appropriate processes to ensure that relevant and reliable financial information is produced. The financial statements have been prepared in accordance with accounting principles generally accepted in Canada and include certain amounts that are based on estimates and judgements. The significant accounting policies that management believes are appropriate for the Trust are described in note 3 to the financial statements.

PricewaterhouseCoopers LLP are the external auditors of the Trust. They have audited the financial statements in accordance with Canadian generally accepted auditing standards to enable them to express to the unitholders their opinion on the financial statements. Their report is set out on page 11.



Robert R. Rafos

President
Northwater Fund
Management Inc.



Benita M. Warmbold, CA

Treasurer
Northwater Fund
Management Inc.

Auditors' Report To the Unitholders of Newcastle Market-Neutral Trust

We have audited the statement of investment portfolio as at December 31, 2001 and the statements of net assets of Newcastle Market-Neutral Trust (the "Trust") as at December 31, 2001 and 2000 and the statements of operations, changes in net assets and financial highlights for the years then ended. These financial statements are the responsibility of the Trust's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We have conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the investment portfolio as at December 31, 2001, the financial position of the Trust as at December 31, 2001 and 2000 and the results of its operations for the years then ended in accordance with Canadian generally accepted accounting principles.

Price Waterhouse Coopers LLP

Chartered Accountants

February 27, 2002

NEWCASTLE MARKET-NEUTRAL TRUST

Statement of Net Assets

As at December 31, 2001 and 2000

| | 2001 | 2000 |
|--|-----------------------|--------------------|
| Assets | | |
| Cash and short-term notes - at market value | \$ 3,424,244 | 6,352,648 |
| Hedge fund investments, at fair value (note 5) (cost: 2001 - \$95,889,455; 2000 - \$98,587,432) | 124,831,949 | 124,189,396 |
| Hedge fund redemptions receivable | 4,651,189 | 12,186,517 |
| | 132,907,382 | 142,728,561 |
| Liabilities | | |
| Professional and custody fees payable | 45,771 | 55,947 |
| Interest and stand-by fees payable | 32,883 | 189,375 |
| Distribution payable | - | 1,831,839 |
| Bank loan (note 8) | 27,055,187 | 29,511,017 |
| | 27,133,841 | 31,588,178 |
| Net assets and unitholders' equity | \$ 105,773,541 | 111,140,383 |
| Number of units outstanding (note 6) | 5,689,659 | 5,909,159 |
| Net asset value per unit | \$ 18.59 | 18.81 |

Signed on behalf of the Trustee,

The Royal Trust Company

Per: 

Danny Thompson
Director, Client Service
RBC Global Services, IIS

Per: 

Chris Lim
Client Service Manager
Global Securities Services

The accompanying notes are an integral part of these financial statements.

NEWCASTLE MARKET-NEUTRAL TRUST**Statement of Operations**

For the years ended December 31, 2001 and 2000

| | 2001 | 2000 |
|--|---------------|-------------|
| Investment income | | |
| Interest | \$ 191,873 | 695,243 |
| Dividends | 89,806 | 117,198 |
| | 281,679 | 812,441 |
| Expenses | | |
| Interest and stand-by fees | 1,437,478 | 2,155,906 |
| Management fees (note 7) | - | - |
| Professional and custody fees | 56,244 | 63,607 |
| Other fees | 152,907 | 158,022 |
| | 1,646,629 | 2,377,535 |
| Investment loss | (1,364,950) | (1,565,094) |
| Realized and unrealized gain (loss) on investments | | |
| Net realized gain (loss) on: | | |
| Hedge fund investments | 14,214,000 | 12,014,876 |
| Currency exchange on hedge fund investments | 1,984,261 | 5,592,867 |
| Currency hedging of investments | (6,555,735) | (5,096,905) |
| Change in unrealized appreciation (depreciation) on: | | |
| Hedge fund investments | (2,162,426) | 5,274,656 |
| Currency exchange on hedge fund investments | 5,700,516 | (477,630) |
| Net gain (loss) on currency, excluding hedge fund investments | (974,182) | (787,699) |
| Net gain on investments for the year | 12,206,434 | 16,520,165 |
| Net income from operations for the year | \$ 10,841,484 | 14,955,071 |
| Net income from operations per unit for the year* | \$ 1.89 | 2.45 |

*Based on the average number of units of 5,735,009 outstanding for the year (2000 - 6,099,284).

The accompanying notes are an integral part of these financial statements.

NEWCASTLE MARKET-NEUTRAL TRUST

Statement of Changes in Net Assets

For the years ended December 31, 2001 and 2000

| | 2001 | 2000 |
|--|----------------|---------------|
| Net assets - beginning of the year | \$ 111,140,383 | 121,925,046 |
| Net income from operations for the year | 10,841,484 | 14,955,071 |
| Unit transactions (note 6) | | |
| Net asset value of units cancelled | (4,241,738) | (10,016,104) |
| Gain on cancellation of units | 508,831 | 2,033,929 |
| | (3,732,907) | (7,982,175) |
| Distributions to unitholders | | |
| Return of capital (note 9) | (12,475,419) | (17,757,559) |
| Net assets - end of the year | \$ 105,773,541 | 111,140,383 |
| Distributions per unit for the year* | \$ 2.17 | 2.89 |

*Based on the actual number of units outstanding on record date.

The accompanying notes are an integral part of these financial statements.

NEWCASTLE MARKET-NEUTRAL TRUST

Statement of Investment Portfolio

As at December 31, 2001

| | Maturity Date | Face Value | Cost | Fair Value | Fair Value as % of Investment Portfolio |
|---|------------------|---------------|---------------|----------------|--|
| Hedge fund investments | | | | | |
| Convertible arbitrage | | | \$ 25,216,346 | \$ 33,646,124 | 26.23 % |
| Distressed securities | | | 6,461,385 | 8,068,872 | 6.29 |
| Fixed income arbitrage | | | 11,607,141 | 13,155,070 | 10.26 |
| Loan origination | | | 5,516,044 | 8,941,899 | 6.97 |
| Market-neutral equity | | | 17,768,959 | 22,662,624 | 17.67 |
| Mortgage-backed securities arbitrage | | | 3,949,079 | 6,505,284 | 5.07 |
| Merger arbitrage | | | 25,370,501 | 31,934,015 | 24.90 |
| | | | 95,889,455 | 124,913,888 | 97.39 |
| Settlement due on currency futures contracts (note 10) | | | - | (81,939) | (0.06) |
| Hedge fund investments, at fair value | | | 95,889,455 | 124,831,949 | 97.33 |
| Commercial paper | | | | | |
| Reliant Trust | March 2, 2002 | \$ 700,000 | 696,731 | 697,788 | 0.54 |
| | | 700,000 | 696,731 | 697,788 | |
| Cash | | - | 2,726,456 | 2,726,456 | 2.13 |
| Total investment portfolio | | \$ 700,000 | \$ 99,312,642 | 128,256,193 | 100.00 % |
| Liabilities over other assets | | | | (22,482,652) | |
| Net assets and unitholders' equity | | | | \$ 105,773,541 | |

The accompanying notes are an integral part of these financial statements.

NEWCASTLE MARKET-NEUTRAL TRUST**Statement of Financial Highlights**

For the periods ended December 31, 2001, 2000, 1999, 1998 and 1997

Net asset value per unit - beginning of the period

Net investment income (loss) per unit

Net gain (loss) on investments

Distribution per unit

Return of capital

Effect of capital transactions over original cost

Net asset value per unit - end of the period

Ratios and supplemental information

Net assets - end of the period

Weighted-average net assets

Ratio of expenses to weighted-average net assets

Annual rate of return

The accompanying notes are an integral part of these financial statements.

| | 2001 | 2000 | 1999 | 1998 | 1997 |
|----|--------|--------|--------|--------|--------|
| \$ | 18.81 | 18.97 | 16.63 | 19.00 | 18.79 |
| | (0.24) | (0.26) | 0.02 | 0.04 | (0.02) |
| | 2.13 | 2.71 | 2.40 | (2.15) | 0.23 |
| | (2.17) | (2.89) | (0.57) | (0.69) | - |
| | 0.06 | 0.28 | 0.49 | 0.43 | - |
| \$ | 18.59 | 18.81 | 18.97 | 16.63 | 19.00 |

| | | | | | |
|----|-------------|-------------|-------------|-------------|-------------|
| \$ | 105,773,541 | 111,140,383 | 121,925,046 | 123,031,606 | 166,674,246 |
| \$ | 109,436,120 | 117,409,394 | 123,106,315 | 147,004,084 | 165,316,009 |
| | 1.50% | 2.03% | 1.66% | 1.95% | 0.81% * |
| | 10.58% | 15.12% | 17.50% | (9.28)% | 1.09% ** |

* Rate annualized from date of inception to December 31, 1997.

** Rate of return reported for period from inception to December 31, 1997.

NEWCASTLE MARKET-NEUTRAL TRUST

Notes to Financial Statements

For the years ended December 31, 2001 and 2000

1. Establishment of the Trust

The Newcastle Market-Neutral Trust (the "Trust") is a closed-end investment trust established under the laws of the Province of Ontario pursuant to a trust agreement made as of July 18, 1997, and restated on August 17, 1999. The Royal Trust Company ("Royal Trust"), acts as Trustee. The Trust began operations on July 30, 1997 when it completed its initial public offering. The Trust's units are listed on The Toronto Stock Exchange under the symbol NMN.UN. The Trust will terminate on or about December 31, 2007, and the net assets will be distributed pro rata to the unitholders unless an alternative later termination date is approved by a two-thirds majority vote of the unitholders at a meeting called for this purpose. The Trust retained Northwater Fund Management Inc. (the "Manager"), formerly Newcastle Fund Management Inc., under a management agreement dated July 18, 1997. Northwater Capital Management Inc. (the "Advisor") acts as the advisor for the Trust and was formed during the year on the amalgamation of Newcastle Capital Management Inc. and NewQuant Capital Inc. The Advisor is registered in Canada as an adviser in the categories investment counsel and portfolio manager and as a dealer in the category limited market dealer under the Securities Act (Ontario), and as an adviser in the category commodity trading manager under the Commodity Futures Act (Ontario). The Advisor is registered as a securities adviser under the Securities Act (Quebec). The Advisor is also registered in the United States as an investment adviser under the U.S. Investment Advisers Act of 1940, as amended, and as a commodity trading advisor and commodity pool operator under the U.S. Commodity Exchange Act, as amended. The Advisor is a member of the U.S. National Futures Association (the "NFA").

2. Investment Objectives of the Trust

The Trust's investment objectives are to: (i) distribute \$0.40 per unit at each quarter end (\$1.60 per annum); (ii) steadily grow the net asset value per unit; (iii) ensure that the performance of the Trust is substantially independent of fixed income and equity markets; and (iv) achieve low volatility, which is expected to be less than that of a mid-term bond portfolio and less than one-half that of major North American stock markets.

3. Summary of Significant Accounting Policies

These financial statements, prepared in accordance with Canadian generally accepted accounting principles, include certain estimates and

assumptions by the Manager that affect the reported amounts of assets, liabilities, income and expenses during the reporting period. Actual results could differ from these estimates. The following is a summary of significant accounting policies followed by the Trust.

(a) Investments

The assets of the Trust are invested in market-neutral hedge funds and money market instruments.

Investment transactions are accounted for on a trade date basis. Investments are valued on the last day of each month ("Valuation Date").

Cash and short-term notes consist of cash in interest bearing accounts at Royal Trust, cash held with the futures broker and commercial paper with maturity of generally less than 90 days when purchased. Cash and short-term notes are valued at the bid price for such instruments at The Toronto Stock Exchange closing time on each Valuation Date. Interest income is accrued on a monthly basis.

Investments in market-neutral hedge funds are valued on the basis of the latest net asset values reported by the portfolio managers or administrators of such funds. The difference between fair value and cost is shown as unrealized gain or loss on investments. Average cost is used to compute realized and unrealized gains and losses.

(b) Foreign Currency Translation

Assets and liabilities in foreign currencies are translated into Canadian dollars at the rate of exchange prevailing at the year end. Transactions during the year in currencies other than Canadian dollars are translated at the rates of exchange prevailing on the respective dates of such transactions. Foreign exchange gains and losses are recognized in the Statement of Operations on each Valuation Date.

(c) Currency Hedging

The Trust enters into exchange-traded currency futures contracts to hedge the Canadian dollar value of portfolio securities and liabilities denominated in foreign currencies.

Upon entering into a futures contract, the Trust is required to deposit an "initial margin" with a broker based on a certain amount per contract. Subsequent payments representing variation margin are made or received each day depending on the daily fluctuation in the value of the contract. These daily changes are recorded as gains or losses in the Statement of Operations. The settlement due on futures contracts represents the daily variation margin owing or due to the Trust on the Valuation Date.

Futures contracts are valued at their settlement price, as published by the appropriate clearing house of the exchange, on each Valuation Date. In the absence of reported bid and offer quotations, the Manager may, from time to time, determine a value which more accurately reflects the fair value based on the current market value of the underlying interest. The notional values of the futures contracts are not recorded as assets in the Statement of Net Assets.

4. Statement of Financial Highlights

The information disclosed in the Statement of Financial Highlights is calculated as described below.

Net asset value per unit is computed by dividing the net asset value of the Trust by the total number of units of the Trust outstanding, as at the beginning or the end of the period.

Net investment income or loss per unit and net gain or loss on investments are based on the average number of units outstanding during the period. Distributions to unitholders per unit are based on the actual number of units outstanding on record date.

Weighted-average net assets are calculated as the average of the monthly net asset values of the Trust during the period.

The ratio of expenses to weighted-average net assets for the Trust is based on all expenses of the Trust, including interest, stand-by fees and GST, expressed as a percentage of the weighted-average net assets.

Annual rate of return is calculated on the basis of the change in the net asset value per unit of the Trust during the period, and takes into account distributions made by the Trust.

The effect of capital transactions over original cost represents calculational differences resulting from the use of different base numbers of units outstanding in the various calculations as described above. This difference can be substantial if the Trust experienced significant cancellations of units during the period.

5. Investment in Market-Neutral Hedge Funds

As part of its investment strategy, the Trust invests in a diversified portfolio of market-neutral hedge funds.

The following table summarizes hedge fund transactions during the year:

| | 2001 | 2000 |
|--|----------------|-------------|
| Investments at cost - beginning of year | \$ 98,587,432 | 124,345,458 |
| Cost of investments purchased | 35,228,738 | 47,504,312 |
| Cost of investments sold | 37,926,715 | 73,262,338 |
| Investments at cost - end of year | 95,889,455 | 98,587,432 |
| Unrealized appreciation of investments | 29,024,433 | 25,486,344 |
| Market value of investments - end of year | \$ 124,913,888 | 124,073,776 |
| Proceeds of investments sold | \$ 54,124,976 | 90,870,081 |
| Cost of investments sold | 37,926,715 | 73,262,338 |
| Net realized gain on investments | \$ 16,198,261 | 17,607,743 |

6. Units Issued and Outstanding

The authorized capital of the Trust consists of an unlimited number of non-redeemable units. Units are transferable and represent an equal, undivided interest in the net assets of the Trust. All units are of the same class with equal rights and privileges. Each unit is entitled to one vote at any meeting of unitholders and to equal participation in any distributions made by the Trust. Fractional units will not be issued. During 2001, under a normal course issuer bid and the Trust's quarterly market support obligation, the Trust purchased 219,500 units (2000: 518,600 units) for cancellation. Units purchased in the market pursuant to the distribution reinvestment plan during 2001 totalled 23,916 (2000: 46,718).

The following unit transactions took place during the year:

| | December 31, 2001 | December 31, 2000 |
|---|-------------------|-------------------|
| Balance of units outstanding - beginning of the year | 5,909,159 | 6,427,759 |
| Units acquired and cancelled during the year | (219,500) | (518,600) |
| Balance of units outstanding - end of the year | 5,689,659 | 5,909,159 |

7. Management Fees

The Manager provides the day-to-day administration, portfolio management and unitholder services to the Trust. In return for these services, the Manager receives an annual fee of 1.25% of the net assets of the Trust, calculated on the last Valuation Date of each fiscal quarter. The fee is paid quarterly in arrears, provided that distributions to unitholders are not in arrears. If distributions are in arrears, management fees are not paid nor payable until any shortfall has been

made up to unitholders. Management fees in arrears at December 31, 2001 amounted to \$7,051,825 (2000: \$5,685,322) and will be paid to the Manager when the shortfall in distributions has been paid (see note 9). The management fees in arrears will only be paid or accrued to the extent that such payment or accrual will not prohibit the payment of distributions to unitholders. The Manager will pay a portion of its fee to the Advisor in consideration of the Advisor's services to the Trust.

8. Bank Loan

The Trust has a revolving loan facility with a Canadian financial institution (the "Bank"). The facility entitles the Trust to borrow funds in Canadian or U.S. dollars up to an amount not exceeding 25% of the net asset value of the Trust for the purposes of making additional investments. In addition, the Trust may borrow, on a temporary basis, up to 10% of the net asset value of the Trust for the purposes of (i) effecting market purchases of units; (ii) maintaining liquidity to effect cash distributions; and (iii) settling currency hedging transactions. Interest and stand-by fees are payable on a monthly basis. Interest rates are based on bank prime and/or Bankers' Acceptances for Canadian funds and bank prime and/or LIBOR for U.S. funds. A general security interest in the assets of the Trust has been provided in favour of the Bank. Loans outstanding as at December 31, 2001 were denominated in Canadian dollars and U.S. dollars.

9. Distributions

The Trust pays quarterly distributions to unitholders of \$0.40 per unit to the extent that the net asset value per unit after giving effect to the distribution is greater than the net asset value on July 30, 1997 of \$18.79. If less than \$0.40 per unit is distributed in any quarter, the amount of the shortfall is carried forward and paid in the next quarter, or quarters, as long as the net asset value per unit after giving effect to the distribution remains greater than \$18.79 per unit.

During the year ended December 31, 2001, distributions of \$2.17 per unit and \$12,475,419 in aggregate (2000: \$2.89 per unit; \$17,757,559 in aggregate) were made by the Trust. At December 31, 2001 distributions of \$0.48 per unit and \$2,731,036 in aggregate (2000: \$1.05 per unit; \$6,204,617 in aggregate) were in arrears.

Unitholders have the option of receiving distributions in cash, or in the form of additional units by way of the distribution reinvestment plan.

10. Currency Futures Contracts

As at December 31, 2001, commercial paper with a face value of US \$700,000 (2000: US \$700,000) was deposited as margin for the currency futures contracts.

The Trust has entered into futures contracts to hedge the currency exposure of portfolio securities and liabilities denominated in foreign currencies.

At December 31, 2001, the Trust held the following currency futures contracts:

| | Closing price | Notional contract value | Settlement due on futures contracts |
|---|--------------------------|--|--|
| 1,029 March 2002 Canadian Dollar Futures Contracts | US \$62.76 | US \$64,580,040 | |
| | | CDN \$102,850,172 | CDN \$(81,939) |

11. Income Taxes

The Trust qualifies as a "mutual fund trust" within the meaning of the Income Tax Act (Canada) (the "Tax Act"). As all of the net income of the Trust, including net realized gains from private investment funds and deemed income computed under Section 94.1 of the Tax Act, will be paid or payable to unitholders in each calendar year, no income tax will be payable by the Trust under the present provisions of the Tax Act. Such income is taxable in the hands of the unitholder. Occasionally, more income is distributed than is earned by the Trust for tax purposes. This excess distribution is called a "return of capital" and is not taxable to the unitholder but reduces the adjusted cost base of the unit for tax purposes.

As at December 31, 2001 the Trust had \$10,000,000 (2000: \$9,700,000) available in non-capital loss carry forwards and no capital loss carryforwards (2000: \$4,000,000). During the year, the Trust utilized all of the available capital loss carry forwards.

12. Subsequent Event

Effective February 1, 2002 the Trust changed its name to Northwater Market-Neutral Trust.

NORTHWATER CAPITAL MANAGEMENT INC.

Northwater Capital Management Inc., the Advisor, is a leading investment management firm in Canada and the U.S., specializing in hedge fund strategies, synthetic indexing, and enhanced asset-class portfolios for pension plans and endowment funds. Wholly-owned by its employees, Northwater is dedicated to providing clients with excellent risk-adjusted returns and first-class client service. Since its founding in 1989, the firm and its affiliates have grown assets under management to over Cdn \$8.0 billion as at December 31, 2001. Northwater's clients include the pension funds of major corporations in Canada, the United States and Europe. Northwater also manages pension assets for a number of universities and public sector institutions and a segregated fund for a large financial institution.

Northwater is known as an innovator and a leader in applying derivatives and other quantitative strategies to create attractive and unique investment products. In 1994, Northwater entered the hedge fund business, founding the NewQuant Trust I, the first investment vehicle of its kind in Canada to invest in a diversified portfolio of hedge funds.

Northwater itself has grown considerably since the inception of the Trust. As of December 31, 2001, the firm and its affiliates had, in total, about Cdn \$3.4 billion under management in the funds of market-neutral hedge funds, making it the largest such player in Canada, and one of the largest in the world. Northwater has a staffed office in New York City and about Cdn \$1 billion under management for U.S. institutional clients.

NEWCASTLE MARKET-NEUTRAL TRUST

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CHANGE OF ADDRESS

Effective April 1, 2002, the address for Northwater Market-Neutral Trust, Northwater Fund Management Inc. and Northwater Capital Management Inc. will be:

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For most recent net asset value update call: 1-888-429-8774

TSE Symbol: NMN.UN

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THE HISTORY OF THE COUNTY OF MIDDLESEX

By JOHN STUBBS, Esq. F.R.S. &c.
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